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BEFORE THE ARIZONA CORPORATION COMMISSION

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GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH

ORIGINAL

IN THE MATTER OF THE APPLICATION OF) DOCKET NO. E-04204A-13-0476
UNS ELECTRIC, INC. FOR AN ACCOUNTING)
ORDER IN CONNECTION WITH THE) **NOTICE OF FILING**
ACQUISITION OF 150 MW OF GILA RIVER)
POWER PLANT UNIT 3.)

UNS Electric, Inc., through undersigned counsel, hereby files the Direct Testimony of
Dallas J. Dukes in the above-captioned docket.

RESPECTFULLY SUBMITTED this 5th day of December 2014.

UNS ELECTRIC, INC.

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By *Jacqueline Howard*

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

GARY PIERCE- CHAIRMAN
BOB STUMP
SANDRA D. KENNEDY
PAUL NEWMAN
BRENDA BURNS

IN THE MATTER OF THE APPLICATION OF) DOCKET NO. E-04204A-13-0476
UNS ELECTRIC, INC. FOR AN ACCOUNTING)
ORDER IN CONNECTION WITH THE)
ACQUISITION OF UP TO A 25% INTEREST IN)
GILA RIVER POWER PLANT UNIT 3.)
_____)

Direct Testimony of

Dallas J. Dukes

on Behalf of

UNS Electric, Inc.

December 5, 2014

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1 **I. INTRODUCTION.**

2
3 **Q. Please state your name and business address.**

4 A. My name is Dallas J. Dukes and my business address is 88 East Broadway Blvd.,
5 Tucson, Arizona 85701.

6
7 **Q. By whom are you employed and what are your duties and responsibilities?**

8 A. I am the Senior Director of Pricing and Economic Forecasting for Tucson Electric
9 Power Company ("TEP"). I am responsible for monitoring and determining revenue
10 requirements, customer pricing and rates structures for all the regulated subsidiaries of
11 UNS Energy Corporation ("UNS Energy"), including UNS Electric, Inc. ("UNS
12 Electric" or the "Company").

13
14 **Q. What is the purpose of your direct testimony?**

15 A. In my testimony, I will provide: (i) an overview of the Company's request for an
16 accounting order authorizing the deferral for future recovery of non-fuel costs associated
17 with its prospective purchase of up to 25% interest in Unit 3 at the Gila River Power
18 Plant ("Unit 3" or the "Plant") including the numerous benefits that UNS Electric and its
19 customers will receive from the acquisition; (ii) a response to Staff's accounting order
20 proposal contained in the Direct Testimony of Gerald Becker, which was filed in the
21 docket on October 28, 2014; and (iii) how the Company's request meets the standard for
22 an accounting order.

23
24 **Q. Please summarize the Company's request in this docket.**

25 A. UNS Electric filed its Application on December 31, 2013 because the Company has a
26 unique opportunity to address its need for base load generation by acquiring a portion of
27 an efficient, combined-cycle natural-gas-fired unit at a reasonable price. In the

1 Application, UNS Electric requested to defer costs including depreciation and
2 amortization, property taxes, O&M expenses, and carrying costs associated with owning,
3 operating and maintaining the Plant. An accounting order would preserve UNS Electric's
4 financial integrity and help the Company maintain its investment-grade credit rating
5 during the cost deferral period. Based on conversations with Staff, UNS Electric revised
6 its request, which I detail later in my testimony and which Staff summarized in its pre-
7 filed testimony.

8
9 **II. THE ACQUISITION AND BENEFITS OF UNIT 3.**

10
11 **Q. Please provide a general description of the Gila River Power Plant.**

12 A. The Gila River Power Plant is located approximately 75 miles southwest of Phoenix and
13 about 30 miles south of the Palo Verde trading hub. It is nearly equidistant from UNS
14 Electric's Mohave County and Santa Cruz County service areas, and rests on
15 approximately 1,100 acres within the Gila Bend town-site. The Plant consists of four
16 "power blocks," with each block representing 550 MW of nominal capacity. At 2,200
17 MW of combined capacity, Gila River is the largest natural gas-fired generating facility
18 in the Western Electric Coordinating Council ("WECC") market zone. The Plant was
19 constructed in four phases, with all phases completed in mid-to-late 2003. Unit 3 was
20 completed in July 2003. The Plant is within its own generation-only balancing authority.

21
22 **Q. Why is UNS Electric's acquisition of the portion of Unit 3 important to its resource**
23 **portfolio?**

24 A. As described in UNS Electric's 2014 Integrated Resource Plan¹ ("2014 IRP"), the
25 Company currently relies on the wholesale market for approximately 85%, or 300 – 325
26 MW, of its annual resource capacity needs. With the planned acquisition of 25% of Unit
27

¹ Filed on April 1, 2014 in Docket No. E-00000V-13-0070.

1 3, UNS Electric will reduce its market-based capacity exposure by 45%. As stated in the
2 Company's Application, UNS Electric's heavy reliance on wholesale power has not
3 proven problematic in recent years when natural gas prices and capacity values have
4 remained low. Over the long term, though, the Company's customers could face
5 significantly higher rates and potential reliability concerns as proposed coal plant
6 closures, carbon costs, increased growth rates and other market forces drive up energy
7 and capacity costs and reduce the availability of low cost market resources. This risk was
8 acknowledged by the Commission in May 2013 when it advised the Company and other
9 load serving entities of the challenges future short-term market purchases in their long-
10 term Integrated Resource Plans could create:

11 *The cost and availability of such purchases are subject to a wide array*
12 *of influences that are difficult, if not impossible to predict. For example,*
13 *if a large number of older coal-fired generating plants are retired in the*
14 *western region, the availability of such purchases will decline*
dramatically, and the cost of such purchases will increase significantly.
Reliance on short term market purchases in a long-term plan is difficult,
if not impossible, to justify. (Decision No. 73884, Page 4)

15
16 **Q. Does the Plant's location provide other benefits to UNS Electric?**

17 A. Yes. One significant advantage of the Gila River Power Plant is its proximity to
18 transmission and natural gas supplies. The Plant is linked to the Palo Verde hub and is
19 interconnected to the extra-high-voltage ("EHV") transmission grid through a pair of 500
20 kilovolt (kV) lines with firm, long-term transmission rights to the Jojoba Switchyard.
21 Gila River Power Plant also has access to natural gas from two different suppliers. The
22 Plant has connections to both El Paso Natural Gas (EPNG) and Transwestern Pipeline
23 Company, L.L.C. ("Transwestern") systems. Through the EPNG and Transwestern
24 systems, the Plant has access to the Permian, San Juan, West Texas, and Waha gas
25 supply. Unit 3's access to transmission means that delivery to UNS Electric's service
26 territories is not an issue. Moreover, access to natural gas supplies means that the Plant
27 will reliably serve those customers under a vast majority of circumstances.

1
2 **Q. How efficient is Gila River Power Plant?**

3 A. It is one of the most efficient combined-cycle plants in the WECC region with a heat rate
4 of approximately 7,000 British thermal units (“BTUs”) per kilowatt-hour (“kWh”). This
5 is significantly more efficient than UNS Electric’s simple-cycle combustion turbines
6 (operating at heat rates from 9,800 to 16,000 BTUs/kWh). Unit 3 provides a solid base
7 load resource by reducing the overall heat-rate when compared to market heat rates and
8 existing assets.
9

10 **Q. How did UNS Electric identify the opportunity to acquire 25% of Unit 3?**

11 A. As set forth in the Application, the opportunity for UNS Electric to acquire a share of
12 Unit 3 was the result of a request for proposals (“RFP”) that UNS Electric’s sister utility,
13 Tucson Electric Power Company (“TEP”) issued in May 2013. The RFP was issued in
14 accordance with the Commission’s Integrated Resource Planning Rules at A.A.C. R14-2-
15 701 through R14-2-706.² TEP concluded that ownership of Unit 3 was the best option
16 compared to other options, but that joint ownership with UNS Electric would be in their
17 mutual best interests (given the size of Unit 3 and the Company’s need for base load
18 resources). The competitive bidding process held by TEP further demonstrates the cost-
19 effectiveness of Unit 3 to UNS Electric.
20

21 **Q. Do you believe that acquiring 25% of Unit 3 is the least expensive option for UNS**
22 **Electric to acquire a substantial base load resource?**

23 A. Yes. As stated in the Company’s Application, the acquisition of 25% of Unit 3 will be far
24 less expensive than a similar commitment in a newly-constructed combined-cycle plant.³
25 The Plant’s location, proximity to transmission and natural gas pipelines, and heat
26

27 ² Specifically, A.A.C. R14-2-705.B provides that a “load-serving entity shall use an RFP process as its
primary acquisition process for the wholesale acquisition of energy and capacity. . . .”

³ See Application (December 31, 2013) at Exhibit 1.

1 efficiencies will give the Company a reliable base load resource that bests comparable
2 resources available on the wholesale market, as demonstrated by the procurement
3 process.

4
5 **Q. Do you believe that these benefits warrant allowing UNS Electric to defer the costs**
6 **of acquiring its 25% portion of Unit 3?**

7 A. Yes. This is an excellent opportunity for UNS Electric to acquire a base load resource at a
8 very reasonable price. I also note that this would significantly mitigate the risks
9 associated with relying too heavily on the wholesale market to supply power to
10 customers. UNS Electric noted in its Application a need for base load resources in its
11 2012 IRP (and confirmed that in its 2014 IRP), and that it will monitor the market for
12 opportunities, including acquiring a low-cost, multi-owner acquisition of an existing
13 combine-cycle gas-fired plant to firm up long-term capacity needs.⁴ In short, acquiring
14 25% of Unit 3 provides UNS Electric with a stable, efficient resource for up to 40% of its
15 long-term capacity needs, reducing its reliance on the wholesale market, giving it access
16 to a right-sized share of a resource uniquely-situated to serve its needs and an opportune
17 partnership with its sister company, TEP. These benefits simply cannot be found
18 elsewhere.

19
20 **Q. What would be the impact to UNS Electric's financial condition if it was unable to**
21 **defer costs related to the purchase of Unit 3?**

22 A. Unit 3 is a significant investment for UNS Electric. The purchase price of approximately
23 \$55 million represents about 28% of the original cost rate base established in the
24 Company's last general rate case. The non-fuel operating costs associated with the
25 Company's purchase of Unit 3 are expected to be approximately \$9 million by the end of
26 2015. To put this into context, if Unit 3 had been purchased in January 2013, UNS
27

⁴ See Application at 2.

1 Electric's reported net income would have fallen by approximately 42% without any cost
2 deferral. Preserving UNS Electric's financial condition during the deferral period is in
3 the public interest.

4
5 **Q. Would the accounting order help the Company maintain its current credit rating?**

6 A. Yes. The Company's debt obligations are currently rated Baa1⁵ by Moody's Investor
7 Service ("Moody's"). The accounting order would be important from the standpoint of
8 perceived level of regulatory support for UNS Electric - a key factor considered by
9 Moody's and others in evaluating the Company's creditworthiness. Without such
10 treatment, the planned purchase of the Plant would impose undue and potentially
11 untenable financial burdens on UNS Electric given the size of the planned investment
12 relative to the Company's current capitalization.

13
14 **III. COMMENTS ON THE STAFF TESTIMONY.**

15
16 **Q. Have you reviewed the pre-filed testimony of Staff witness Gerald Becker docketed**
17 **on October 28, 2014?**

18 A. Yes I have.

19
20 **Q. What was Staff's recommendation regarding UNS Electric's deferral request?**

21 A. Staff describes the revision to the Company's request that the Company provided to Staff
22 on September 15, 2014 via email. Specifically, the Company's amended request was as
23 follows:

- 24 • The non-fuel costs associated with owning, operating and maintaining UNSE's share
25 of Unit 3 shall be deferred including: O&M expenses, depreciation and amortization
26

27

⁵ UNSE's rating has been upgraded from Baa2 since the Company filed its Application.

1 expense, property taxes and carrying costs. Carrying costs are to be accrued on the
2 Company's investment in the Plant at a debt cost of 5.0%.

- 3 • The reductions to UNSE's purchased energy and capacity costs would be retained by
4 the Company from the purchase date (presumably no later than January 2015)
5 through the date on which the Plant is placed into rate base upon completion of the
6 Company's next rate case.
- 7 • During this period, the purchased energy and capacity savings would serve to off-set
8 all, or a portion of, the increase in the Company's non-fuel costs associated with
9 owning and operating Unit 3. These costs include O&M expense, depreciation and
10 amortization expense, property taxes and carrying costs.
- 11 • Upon completion of the Company's next rate case, the ongoing energy and capacity
12 cost savings provided by Unit 3 would be passed onto customers, thus mitigating an
13 expected future increase in the Company's non-fuel base rates.
- 14 • The purchased energy cost savings shall be calculated monthly based on the
15 difference between the actual Unit 3 fuel costs (net of revenues from short-term
16 wholesale sales) and the market value of Unit 3 energy production used to serve retail
17 load (calculated using published on and off-peak market prices from the
18 Intercontinental Exchange ("ICE").)
- 19 • The avoided cost of capacity purchases shall be \$1.52 per kW/month, which is based
20 on third-party quotes for 2015 demand (capacity) options, which is approximately
21 \$2.5 million on an annual basis.
- 22 • The margin from short-term wholesale sales shall be based on revenues from short-
23 term wholesale sales less the actual fuel costs for Unit 3 allocated to wholesale sales.
- 24 • The reductions to UNS Electric's purchased energy and capacity costs, and the
25 increases in the margin on short-term wholesale sales, resulting from the ownership
26 of Unit 3, shall be calculated monthly.

- 1 • The amount of these cost savings recovered through UNSE's PPFAC shall not be
2 included in the Accumulated PPFAC Bank Balance for purposes of calculating
3 accrued interest.

4 Staff agrees that the net benefit of any wholesale value arising from the ownership of
5 Unit 3 should be deferred. Staff also recommended a clarification of the calculation of
6 the cost savings.

7
8 **Q. What are the benefits of the deferral proposed by Staff?**

9 A. The proposal in Staff's testimony reflects discussions between Staff, RUCO and the
10 Company. Although the proposal is somewhat different than what the Company initially
11 proposed, there are several benefits to this approach, including (i) a better matching of
12 customer savings with the costs associated with owning and operating Unit 3, (ii)
13 mitigation of the initial customer rate impact expected to result from UNS Electric's next
14 rate case and (iii) improved cash flow for UNS Electric during the cost deferral period,
15 which should further support the Company's investment grade credit rating.

16
17 **Q. Has the Company prepared a Plan of Administration as requested in the Staff**
18 **Testimony?**

19 A. As of the filing of this testimony, the Company is working with Staff and RUCO to
20 develop a Plan of Administration ("POA"). The Company intends to finalize the POA
21 with Staff and RUCO, and file it before the hearing on December 15, 2014.

22
23 **Q. What is your response to Staff's clarification of the savings?**

24 A. The POA will clarify the definition of savings.
25
26
27

1 **Q. Staff also recommends time and dollar limitations to the cost deferral authorization**
2 **(specifically that any deferral will cease on May 1, 2016 and be no more than \$10.5**
3 **million). Does the Company support those recommendations?**

4 A. The Company's Application did not include these types of limitations. However, UNS
5 Electric does not oppose Staff's recommendations regarding a cap for the deferral amount
6 and an end date for the deferral period. From a customer perspective, this is another
7 benefit of the deferral mechanism recommended by Staff.
8

9 **Q. Staff also indicates the costs eligible for deferral must be specified and not be open-**
10 **ended to include any "other non-fuel plant costs." What is UNS Electric's**
11 **response?**

12 A. The Company does not oppose excluding "other non-fuel plant costs" from the costs
13 eligible for deferral. However, the deferral needs to include, as outlined in Staff's
14 testimony,⁶ O&M expense, depreciation and amortization expense, property taxes and
15 carrying costs.
16

17 **Q. Could you clarify the Company position with regards to Decision No. 73884?**

18 A. Yes. In Decision No. 73884, the Commission acknowledged UNS Electric's 2012
19 Integrated Resource Plan as provided for in the IRP rules. UNS Electric agrees Decision
20 No. 73884 did not order it to purchase generation. However, the Company wanted to
21 point out that the Decision highlighted the concern regarding over-reliance on short-term
22 market purchases and that the Commission acknowledged that risk. *One* of the ways to
23 reduce that reliance is to acquire a base load resource. This is a major reason why
24 acquiring Unit 3 is important to UNS Electric and why the Company seeks the
25 accounting order – so that the Company can acquire a highly efficient generation asset at
26 a reasonable price. In short, the acquisition is in the best interest of our customers and
27

⁶ See Staff Testimony at 7-8.

1 the Company is pleased that Staff supports a means to allow UNS Electric to achieve that
2 end.

3
4 **Q. Was there anything else from Mr. Becker's pre-filed testimony you wanted to**
5 **address?**

6 A. No. UNS Electric appreciates Staff's support of our efforts to acquire a portion of Unit 3
7 and willingness to reach a compromise that would allow for the deferral of non-fuel costs
8 associated with the Plant as I have detailed above.

9
10 **IV. STANDARDS FOR AN ACCOUNTING ORDER.**

11
12 **Q. What do you understand to be the Commission's standard for approval of an**
13 **accounting order similar to what UNS Electric is requesting?**

14 A. The most recent case I am aware of involving a request for an accounting order involved
15 Arizona Public Service Company ("APS") and its request to (among other things) defer
16 costs associated with acquiring Southern California Edison Company's ("SCE") share of
17 Units 4 and 5 of the Four Corners Generating Station ("Four Corners 4 and 5"). This
18 request was made in 2010.⁷

19
20 In that Decision, the Commission essentially stated that a variation from the typical
21 ratemaking treatment (approving an accounting order through establishing a regulatory
22 asset to defer costs typically expensed) is appropriate if there are benefits to be obtained
23 from the transaction at issue. In that case, the Commission largely approved APS's
24 request to defer for possible later rate recovery all non-fuel costs of owning, operating
25 and maintaining the acquired interests in each generation plant. The Commission
26 approved APS's request. The Commission found in both cases, based on the

27

⁷ See Decision No. 73130 (April 24, 2012).

1 circumstances, that the benefits to the acquiring SCE's share of Four Corners 4 and 5
2 warranted a variation from the usual ratemaking treatment.⁸ The Commission found that
3 APS's identified benefits for the transaction justified deferral. Those benefits included:
4 (1) that acquiring Units 4 and 5 is the lowest cost option to acquire needed base load
5 generation⁹; (2) preserves an existing interest in reliable low-cost generation¹⁰; (3) allows
6 APS to maintain a diversified portfolio¹¹; and (4) provides for environmental benefits.¹²
7

8 There are other examples of the Commission approving deferral of costs under an
9 accounting order such as Central Arizona Project holding charges.¹³ Previous decisions
10 reflect similar considerations but ultimately depend on the particular circumstances of the
11 request.
12

13 **Q. Does the acquisition of Unit 3 satisfy the standard for approval of an accounting**
14 **order?**

15 A. Yes. As noted throughout this testimony, there are significant benefits to both the
16 Company and its customers that fully justify the issuance of an accounting order as
17 outlined in Staff's testimony.
18
19
20
21
22
23
24

25 ⁸ See Decision No. 73130 at 36.

26 ⁹ Id at 8-9.

27 ¹⁰ Id. at 9-10.

¹¹ Id. at 10-11.

¹² Id. at 11-12.

¹³ *In re Agua Fria Water Division of Citizens Comm. Co.*, Decision No. 58750 (August 31, 1994).

1
2 **V. CONCLUSION.**

3
4 **Q. Do you have any concluding remarks?**

5 A. An accounting order will help facilitate UNS Electric's purchase of a strategically
6 located, reasonably priced, natural gas generating facility. The purchase of Unit 3 would
7 provide UNS Electric with a stable, efficient generating resource for 40 percent of its
8 long term capacity needs, reducing its reliance on the wholesale market and helping the
9 Company reliably integrate an increasing share of renewable resources into its portfolio.

10
11 Additionally, the accounting order itself provides benefits including:

- 12 • No bill impact to customers during the deferral period. The deferral treatment
13 of Unit 3 will not result in any immediate change to customer bills since both
14 the costs and benefits of owning Unit 3 will be deferred to the Company's
15 next rate case.
- 16 • No material impact to UNS Electric's financial condition during the deferral
17 period. The accounting deferral allows the Company to align the costs and
18 benefits of Unit 3 without materially impacting UNS Electric's financial
19 condition or credit rating.
- 20 • No determination of prudence by the Commission, Staff or RUCO of the
21 Company's purchase of Unit 3. The Commission will be able to review the
22 purchase of Unit 3, and all related costs and benefits, when the Company files
23 its next rate case.

24
25 **Q. Does that conclude your testimony?**

26 A. Yes, it does.
27